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SUBJECT: ECONOMIC SLOWDOWN HITS CHINA'S TRANSPORT SECTOR

REF: BEIJING 4615

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¶1. (SBU) SUMMARY: China's maritime transport and civil aviation sectors are beginning to show signs of stress from the global economic slowdown. After nearly 10 straight months of double digit growth this year, November port volumes were up just 2 percent over the previous year. Shipping companies have cut rates dramatically, putting serious pressure on their profitability, and resulting in informal cancellation of orders to ship builders. In the aviation sector, the Civil Aviation Authority of China (CAAC) encouraged airlines to cancel aircraft orders to cope with the slowdown in traffic growth. Two of China's big three carriers have received government cash infusions and are reportedly looking for more, and at least one private airline suspended passenger service. At present, Boeing China reports no cancelled or delayed orders. But as China's export engine slows from the fall in foreign demand, the transport sector which links China's people and business to the world can serve as a useful bellwether of change. END SUMMARY.

Port Volumes Slow Considerably, Shippers Feel the Pain

¶2. (SBU) Signs of an economic slowdown are beginning to be felt in China's port system. Preliminary Ministry of Transport (MOT) data for November 2008, indicate port cargo volumes rose just 1.9 percent over the previous November. Between January and October 2009, year-on-year (YOY) port cargo volumes had been increasing at between 9 and 23 percent. On a month-to-month basis, cargo volume fell 3 percent in September, 1.4 percent in October, and 5.1 percent in November, to just 460 million tons. Foreign trade cargo growth slipped to 5 percent (YOY increases) in September and October, after consistently posting a 20 percent growth rate. On the air cargo side, Beijing Capital International Airport announced a 17.8 percent drop in cargo in November.

¶3. (SBU) Industry sources report that the shipping industry in China has been seriously affected by the global economic downturn. Shipping companies American President Lines (APL) and COSCO have both seen a significant decline in business in recent months. Representatives of the two companies told EconOff they both recently cut their capacity for trans-Pacific trade by 20-25 percent. The APL representative said Shenzhen and other southern ports have been hardest hit but ports in northern China "also feel the pain." He reported that APL ships from China are 70-80 percent full and that the price per container for Asia-Europe routes has dropped from a high of USD 2,500 in 2006 to less than USD 1,000 today, a price that is barely profitable. He also noted that some shipping companies have cancelled orders for new ships in spite of financial penalties. The COSCO representative predicted that shipping companies will

face tough times for the next two years. He said some smaller shipping companies face the danger of bankruptcy, although he noted that COSCO can weather the storm because of huge profits from the last five years.

Cancelled Ship Orders are Hidden...

¶4. (SBU) Singapore's Pacific Carriers reports that the drops in international trade and worsening business climate for shipping companies have resulted in some 382 cancelled ship orders worldwide, totaling some 20 million deadweight tons. Of these, the company estimates, more than half are to Chinese shipbuilders, yet there have been minimal public announcements here of such cancellations. In an early December Caijing Magazine article, China Shipping Industry Economic Research Center lead researcher Bao Zhangjing stated that even when orders have been cancelled or delayed, shippers and ship builders are unwilling to admit it. The article quotes an unnamed Zhejiang shipping company executive's description of informal renegotiation of delivery terms which allow shipping companies to postpone or soft cancel orders, and avoid losing the 20-30 percent down payment. They are then able to resume construction contingent upon an industry recovery. Such soft cancellations help shippers limit losses, and both shippers and builders can avoid a negative impact to stock prices or their access to credit that a more public acknowledgement of the downturn would pose.

...Yet Airlines "Encouraged" to Cancel Aircraft Orders
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¶5. (SBU) On December 9, the Civil Aviation Authority of China (CAAC) "encouraged" airlines to cancel or defer new airplane deliveries in order to cope with the decline in passengers caused by the global financial crisis. China Southern, China Eastern Airlines and Shanghai Airlines quickly announced they would review upcoming aircraft deliveries based on passenger demand. China Southern, which operates China's largest fleet, added that they could trim capacity without cancelling orders. Flag carrier Air China announced it would not change its 2009 deliveries. A Boeing spokesperson confirmed that the company has not yet received any cancelled orders or delays. An analyst at CITIC China Securities anticipates airlines won't cancel orders unless they have no other choice, and will first reduce capacity by other means. (NOTE: Some industry source's have observed to Embassy commercial officer that the CAAC announcement was largely intended to target Airbus in retaliation for French President Nicolas Sarkozy's official meeting with the Dalai Lama. END NOTE.)

¶6. (SBU) CAAC's December 9 measures also include a refusal to accept applications for new airlines before 2010; introduction of lower fuel prices, taxes and fees continued support for mergers in order to reduce spending and improve stability; subsidies for 100 air routes to remote areas, and a RMB 10 billion fund to support building air safety facilities. CAAC hopes these measures will enable the industry to maintain 10 percent growth in 2009. The government has already made good on reducing fuel costs, cutting jet fuel prices 32 percent on December 18 (reftel). The State-owned Assets Supervision and Administration Commission (SASAC) conducted a management shuffle among Air China's parent company, China Southern, and China Eastern. The changes are expected to pave the way for a possible China Eastern and Shanghai Airlines merger.

In "Interesting Times," Go for the Direct Subsidy
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¶7. (SBU) China Southern Airlines and China Eastern Airlines each received cash infusions of RMB 2.3 billion (USD 235 million) from their respective holding companies to help the airlines cope with recent losses due to weakening demand. China Southern's funds came directly from a Ministry of Finance (MOF) subsidy to its parent company. China Eastern will reportedly seek an additional RMB 10 billion (USD 1.5 billion) in capital injection from the MOF and the State-owned Assets Supervision and Administration Commission

(SASAC). Air China, although in better financial condition, is also reported to be interested in an injection of funds. All three major Chinese airlines are expected to post net losses this year. China's nascent private airlines sector is finding it more difficult to weather the downturn. In an attempt to raise profitability Beijing's Okay Airways filed to suspend passenger services for one month from December 15, although the company still operates a cargo service.

¶8. COMMENT. Although many transport industry indicators still show growth, the dramatic slowdown in the pace of that growth is telling - and is clearly hitting the industry hard. Post anticipates more grim days ahead, with official statistics ultimately reflecting an actual downturn in some sectors. As the transport industry is forced to admit to the reality of the economic downturn, we anticipate more state-owned enterprises (SOEs) will request government support, per the airline example described above.

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